


# RSU vs ESOP vs Sweat Equity Shares: Differences and Tax Treatment (2026-27)

## Description

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**Quick summary**

- An ESOP is a right to buy shares at a fixed price; an RSU is a promise of shares for no payment once vesting conditions are met; sweat equity shares are issued at a discount or for know-how or similar value.
- All three are taxed the same way under section 17(1)(d): fair market value on allotment less what you paid is a perquisite taxed as salary.
- After that, the FMV becomes your cost of acquisition and the holding period runs from allotment; long-term gains on unlisted and foreign shares are taxed at 12.5% without indexation.
- Company law differs: sweat equity is locked in for three years and capped, while ESOPs need a minimum one year between grant and vesting.

Companies share their ownership with employees in three common ways: employee stock options (ESOPs), restricted stock units (RSUs) and sweat equity shares. They look similar in an offer letter, but they differ in what you pay, when you get the shares and the company law rules behind them. The tax follows one pattern for all three.

## What each one is

**ESOP.** The company grants you an option, a right but not an obligation, to apply for shares at a fixed price after the vesting period. You decide whether to exercise. Market price matters: if it is below the exercise price on the exercise date, you simply let the option lapse.

**RSU.** The company promises a number of shares, free of cost, once conditions are met. The conditions can be time-based (stay for a period), milestone-based (a target is reached) or both. If you leave before vesting, the RSUs are normally cancelled. RSUs are common with listed and foreign parent companies.

**Sweat equity shares.** Shares issued by a company to its employees or directors at a discount or for consideration other than cash, for providing know-how, intellectual property rights or value additions. They are

allotted directly, not through an option.

## Comparison

| Point | ESOP | RSU | Sweat equity shares |
|---|---|---|---|
| Nature | Right to buy at a fixed price | Promise of shares for no payment | Shares issued at a discount or for non-cash value |
| Payment by employee | Exercise price in cash | Nothing | Discounted price, or none |
| Employee's choice | Can choose not to exercise | Receives the shares on vesting | Receives the shares on allotment |
| Companies Act definition | Section 2(37) and Rule 12 | Not defined separately; Indian companies usually run RSUs under the employee stock option framework, so check the plan document | Section 2(88) and section 54, Rule 8 |
| Statutory lock-in | None, company decides | None, company decides | Three years from allotment (Rule 8) |
| Statutory cap | Not set by the Rules | Not set by the Rules | 15% of existing paid-up equity capital or ?5 crore of issue value, whichever is higher, in a year, and 25% of paid-up equity capital in total (Rule 8(4)); relaxed for start-ups recognised by DPIIT for up to ten years from incorporation |
| Minimum vesting | One year between grant and first vesting (Rule 12) | As per plan | Not applicable |

The Companies Act points are from Rules 8 and 12 of the Companies (Share Capital and Debentures) Rules, 2014, checked against the text as amended up to 2020. They apply to a company other than a listed company that is not required to follow the SEBI regulations; a listed company follows the SEBI regulations on employee benefits and sweat equity instead. Both Rules require a special resolution. Rule 12 also excludes promoters, the promoter group and directors holding more than 10% from ESOPs, a restriction that does not apply to DPIIT-recognised start-ups for up to ten years from incorporation. Sweat equity is valued by a registered valuer (Rule 8(6)). The Rules are amended from time to time, so confirm the current text.

## Income tax: one pattern for all three

Section 17(1)(d) of the Income-tax Act, 2025 taxes the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the current or a former employer, **free of cost or at a concessional rate**. The value is the fair market value less the amount you paid or that was recovered from you (section 17(4)(h)).

| Point | ESOP | RSU | Sweat equity |
|---|---|---|---|
| Taxed at | Exercise of the option | Allotment of the shares on vesting | Allotment |
| Perquisite | FMV less exercise price | The whole FMV (you paid nothing) | FMV less the price you paid |
| Head | Salaries, TDS under section 392 | Salaries, TDS under section 392 | Salaries, TDS under section 392 |

For the valuation rules (listed and unlisted shares, merchant banker, the 180 day window) and the eligible start-up deferral, see our post on ESOP taxation.

### Foreign parent company shares

Rule 15(6) values a listed share as the average of the opening and closing price on a **recognised stock exchange**, and that term means a recognised Indian exchange. A share listed only abroad is, on the wording, “not listed on a recognised stock exchange”, which points to a **merchant banker’s valuation** under Rule 15(6)(d). The Rules do not say that the foreign market price can be used. In practice, employers and advisers commonly use the closing price on the foreign exchange on the vesting date, because a public quote exists. That is a convention, not a rule, so ask your employer which method it applies and keep the working. A merchant banker’s certificate is the safest support if the amount is large.

A value in a foreign currency is converted at the **telegraphic transfer buying rate of the State Bank of India** (Rules 206 and 207). For salary, the rate is that of the **last day of the month before** the month in which the salary is due, and for the sale of the shares (capital gains), the last day of the month before the month of transfer. The conversion dates are therefore different for the perquisite and for the sale.

## On sale: capital gains

- **Cost of acquisition:** the FMV taken as the perquisite (section 73, Table serial 4).
- **Holding period:** from the date of allotment.

| Shares | Short-term if held for | Short-term gain | Long-term gain |
|---|---|---|---|
| Listed in India, sold on an exchange with STT paid | 12 months or less | 20% | 12.5% on the gain above ?1,25,000 in the year |

| Shares | Short-term ifheld for | Short-term gain | Long-term gain |
|---|---|---|---|
| Unlisted Indian shares | 24 months orless | Slab rates | 12.5% without indexation |
| Foreign shares | 24 months or less | Slab rates | 12.5% without indexation |

Some articles show a 20% long-term rate for unlisted shares. For tax year 2026-27 the Act says 12.5% (section 197).

**Example (RSU of a foreign parent):** 100 RSUs vest and are allotted on 10/06/2026 when each share has an FMV of ?2,000. Perquisite = ?2,00,000 (nothing was paid), taxed as salary. You sell all 100 shares after 25 months at ?2,600 each. Gain = (2,600 - 2,000) × 100 = ?60,000, long-term, taxed at 12.5% without indexation = ?7,500 plus cess (the ?1,25,000 exemption applies only to listed Indian equity sold with STT).

## Which is better

It depends on the company and your risk appetite.

- An **RSU** is simpler: you pay nothing and have value whenever the shares have value, but you pay income tax on the whole value at vesting.
- An **ESOP** needs your cash to exercise and may expire worthless, but the exercise price is fixed, so a large rise in the share price benefits you, and you choose when to trigger the tax.
- **Sweat equity** is usually for founders and key people who bring know-how or intellectual property; the three year lock-in matters.

Employers rarely give you a choice, so the practical task is to know the tax at the moment the shares reach you and to keep money ready for it.

## Frequently asked questions

### What is the difference between RSU and ESOP?

An ESOP gives you the right, not the obligation, to buy shares at a fixed price after vesting. An RSU is a promise of shares at no cost once the vesting conditions are met, so you do not pay to receive them.

### How are RSUs taxed in India?

When the shares are allotted to you, their fair market value less any amount you paid (usually nil) is a perquisite taxed as salary under section 17(1)(d), with TDS. Later, the gain over that value is a capital gain.

### Are sweat equity shares taxed differently?

No. Section 17(1)(d) covers any specified security or sweat equity shares allotted free of cost or at a concessional rate. The tax on sale follows the same capital gains rules.

### Is there any tax if I never exercise my ESOP?

No. A right that is not exercised is not taxed.

### What is the lock-in for sweat equity shares?

Three years from allotment under Rule 8 of the Companies (Share Capital and Debentures) Rules, 2014. ESOP shares have no statutory lock-in; the company decides.

### Which is better, an RSU or an ESOP?

Neither is better for every employee. An RSU always has value if the shares have value, because you pay nothing. An ESOP can give a bigger gain if the share price rises well above the exercise price, but you must pay to exercise and the options are worthless if the price stays below the exercise price.

## Official sources

- Income Tax Department: Income-tax Act, 2025 (sections 17, 73, 196 to 198)
- Income Tax Department: Income-tax Rules, 2026 (Rule 15(6) to (8), Rule 206)
- Companies (Share Capital and Debentures) Rules, 2014 (Rules 8 and 12, as amended)

## Disclaimer

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